

CALIFORNIA DEPARTMENT OF FOOD AND AGRICULTURE
AUDIT OFFICE

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MENDOCINO WINEGRAPE AND WINE COMMISSION

AUDIT REPORT #08-079

MENDOCINO WINEGRAPE AND WINE COMMISSION

AUDIT REPORT

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AUDIT REPORT NUMBER

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TABLE OF CONTENTS

	<u>PAGE</u>
AUDITOR’S REPORT	1
EXECUTIVE SUMMARY	2
KEY RECOMMENDATIONS	3
REPORTABLE FINDINGS	4
Improper Use of Commission Revenue	4
Internal Control Deficiencies	6
MENDOCINO WINEGRAPE AND WINE COMMISSION'S RESPONSE.....	9
CDFA EVALUATION OF RESPONSE.....	13
DISPOSITION OF AUDIT RESULTS.....	14
REPORT DISTRIBUTION.....	15

Mr. Robert Maxie, Branch Chief
Marketing Services
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The California Department of Food and Agriculture (CDFA), Division of Marketing Services, Marketing Branch, requested the Audit Office to perform a limited scope fiscal and compliance audit of the Mendocino Winegrape and Wine Commission (Commission). It should be noted that our limited scope audit was performed because our office was notified of possible inappropriate behavior. Our objective was to determine whether there was a misuse of assessment funds. In addition, our office was to identify any internal control weaknesses we noted upon examination of the Commission's financial records.

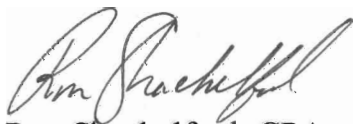
Our audit scope was limited to September 1, 2006 through February 29, 2008 and focused primarily on the accountability of Commission deposits. However, we reviewed other information, which covered other years and other entities if it was readily accessible and/or may have assisted us in understanding a particular issue.

To accomplish the overall audit objectives, our audit methodology consisted of, but was not all inclusive of, a review of the Commission's:

- General ledger detail and various financial related documents
- Bank statements, canceled checks, and deposits
- Revenue sources
- Selected expenses and the agreement with the Mendocino Winegrowers Foundation

We conducted our audit in accordance with Generally Accepted Government Auditing Standards, issued by the Comptroller General of the United States.

This audit report is intended solely for the information and use of the management of the CDFA and the Commission and should not be used for any other purpose.



Ron Shackelford, CPA
Chief, Audit Office
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EXECUTIVE SUMMARY

The California Department of Food and Agriculture (CDFA), Division of Marketing Services, Marketing Branch, requested the CDFA Audit Office to perform a limited scope fiscal and compliance audit of the Mendocino Winegrape and Wine Commission (Commission) to determine whether certain activities and expenditures incurred comply with the law and are within Board authority. In order to accomplish this, our primary focus was the Commission's revenues. We noted the following administrative weaknesses:

- Employee A of the Commission improperly deposited \$191,744 of Commission revenue into the Mendocino Winegrowers Foundation (Foundation). Based on conversations with Commission staff, the revenue deposited into the Foundation's bank account was used to pay for business expenses of the Commission, the Foundation, and the Mendocino Winegrowers Alliance, and for questionable expenses. This revenue consisted primarily of State mandated assessment payments from 170 assessment payers. Our analysis of the Foundation's expenses revealed questionable expenses totaling \$106,025. Subsequently, Employee A repaid \$57,250 to the Commission even though the Foundation paid for these expenses from their bank account. Overall, the improper deposits, Employee A's repayment, and other instances that affect the Commission, resulted in what appears to be a loss of \$91,579 to the Commission.
- The lack of proper internal controls, such as segregation of duties, allowed Employee A to improperly deposit Commission revenues into the Foundation bank account without being detected.
- An adjusting journal entry was made for \$41,322 to the Commission records without sufficient detail to support the entry.
- A comparison of the assessment reports and the payments revealed that some assessment payers may have paid less than the required tonnage fee due to miscalculations on the assessment report.
- The Commission reimbursed Employee A for \$4,051 in meals without an itemized receipt. Even though the purpose and recipients of the meal were noted the majority of the time, having an itemized restaurant receipt provides transparency to the nature and reasonableness of the expense. Additionally, Employee A was reimbursed \$82 for in-room movies charged to the hotel room, which we deem as personal expense since it does not further the Commission's mission.
- Due to our limited audit scope, the only contract we reviewed was the agreement between the Commission and the Foundation. The Commission is to provide management and administrative services to the Foundation for \$1 annually. According to Commission staff, this agreement was formalized after Employee A left in 2008. The Commission should be cautioned that conducting business without a formalized agreement exposes the Commission to loss. Furthermore, the consideration of \$1 annual does not cover any of the Commission's overhead expense to perform services for the Foundation.

KEY RECOMMENDATIONS

1. *Due to the seriousness of the issues raised, the Commission should contact the proper authorities so that investigations into these issues may be performed.*
2. *In cooperation with CDFA, the Commission should perform a comprehensive review of all current internal controls over revenue to improve its accountability and to ensure there is proper segregation of duties. This review should document the current controls in place that are intended to safeguard the revenue.*
3. *Adjustments to the general ledger should not be made unless they are thoroughly analyzed and properly documented to ensure the general ledger properly reflects the entity's operations.*
4. *The Commission should review and compare the assessment reports to the payee checks to ensure the assessment payer correctly paid the mandatory assessment fees.*
5. *The Commission should require an itemized receipt as support for all reimbursement of charges on the employee's personal credit card, including business meals.*
6. *The Commission should only incur expenses necessary to support the Commission's mission. Reimbursements should be reviewed and scrutinized prior to payment. Only expenses that are for a legitimate Commission purpose should be reimbursed.*
7. *The Commission should ensure all contractual relationships are formalized prior to the execution of the agreement. This will protect the Commission if a dispute were to arise.*
8. *The Commission should revisit the agreement with the Foundation to ensure all costs associated with the Foundation are recovered. We urge the Commission to adopt a full cost recovery policy that includes overhead costs when contracting to provide any services to the Foundation.*

REPORTABLE FINDINGS

IMPROPER USE OF COMMISSION REVENUE

Employee A of the Mendocino Winegrape and Wine Commission (Commission) improperly deposited \$191,744 of Commission revenue into a separate entity's bank account and used this revenue to pay for various expenses, some of which were questionable. The Commission has a contractual relationship with this other entity, the Mendocino Winegrowers Foundation (Foundation), to which it provides administrative and management services. According to Commission staff, Employee A had control of both entities' bank accounts and was responsible for the bank deposits. As of our fieldwork date, we were unable to interview Employee A, since Employee A separated in February 2008. Therefore, our office relied on the discussions with Commission staff regarding both entities' operations, as well as other financial information.

Based on bank deposit slips and bank statements, from September 1, 2006 through February 29, 2008, we noted the Commission revenue improperly deposited into the Foundation bank account consisted primarily of State mandated assessment fees. The fees were paid by checks from approximately 170 assessment payers and mailed to the Commission. Not only did Employee A improperly deposit the Commission revenue into the Foundation bank account, Employee A also did not receipt or record this revenue into the Commission's records. Therefore, bank reconciliations of the Commission accounts would not have identified this type of improper activity.

In order to account for the \$191,744 improperly deposited into the Foundation's bank account, copies of all the canceled checks from that account were provided to us. Based on our review of these canceled checks, we noted the Commission revenue improperly deposited in the Foundation account was subsequently used to pay for various expenses. Based on conversations with staff and our review of canceled checks, some of the expenses appeared to be business expenses, whereas other expenses appeared questionable. The business expenses were for the Commission, the Foundation, and the Mendocino Winegrowers Alliance, which the Commission was formally known as prior to the Commission's inception. From September 1, 2006 through February 29, 2008, we noted a total of \$106,025 in questionable expenses paid by the Foundation, which consist of the following:

Table 1

Audit of Mendocino Winegrape and Wine Commission	
Questionable Expenditures Paid from the Foundation Bank Account	
For the Period September 1, 2006 through February 29, 2008	
Payee	Amount Paid
Credit Card Vendors:	
Credit Card #1	\$ 34,716
Credit Card #2	28,690
Credit Card #3	16,893
Credit Card #4	16,073
Credit Card #5	4,847
Credit Card #6	2,000
Subtotal	\$ 103,219
Other Vendors:	
Health Care Provider	\$ 2,287
Cell Phone Company	519
Subtotal	\$ 2,806
Total Questionable Charges	\$ 106,025

Per discussions with Commission staff, it did not appear that the Foundation or the Commission had corporate credit cards. Additionally, according to correspondence on file from Employee A, the credit cards were opened in the name of the employee to pay for business expenses. However, we were never provided copies of these credit card statements to determine the expenses charged. On April 14, 2008, the Commission received and deposited a personal check from Employee A in the amount of \$57,250. Employee A provided the Commission with a list of checks which identified the individual expenses that totaled this amount. The \$57,250 Employee A repaid is far less than the questionable expenses reviewed by our office on **Table 1**.

Our office attempted to determine the overall financial consequence to the Commission resulting from the loss of revenue totaling \$191,744. Since Employee A had control over both entities, we reviewed the exchange of money between the two entities' bank accounts. With the exception of one check written to the Foundation and deposited to the Commission's bank account for \$100, no other instances were noted in which Foundation checks were deposited into the Commission bank account. However, we noted three additional circumstances which helped lessen the financial impact. First, Employee A

reimbursed \$57,250 to the Commission. Second, we noted certain Commission related expenses totaling \$32,815 which the Foundation paid. Lastly, Employee A wrote a check from the Foundation's bank account in October 2007 payable to the Commission for \$10,000. Therefore, after careful review, it appears that the net overall loss to the Commission is approximately \$91,579, which is detailed on **Table 2**.

Table 2

Audit of Mendocino Winegrape and Wine Commission CDFA Determination of Current Shortage of Commission Revenues	
Transaction Description	Amount
Funds Improperly Deposited into Foundation Account	\$ 191,744
less:	
Employee A's Repayment to the Commission	(57,250)
Foundation Transfer of Funds back to Commission	(10,000)
Checks Payable to Foundation Deposited in Commission Account	(100)
Commission Expenses Paid by Foundation	(32,815)
Net Shortage of Commission Revenues	\$ 91,579

Recommendation

1. *Due to the seriousness of the issues raised, the Commission should contact the proper authorities so that investigations into these issues may be performed.*

INTERNAL CONTROL DEFICIENCIES

Although the primary purpose of our audit was to investigate the shortage of Commission revenues, our office noted the following internal control deficiencies, which should be corrected in order to improve the overall operations of the Commission:

Lack of Segregation of Duties

The Commission revenue being deposited to the Foundation's bank account was attributed to the lack of internal controls, in particular, segregation of duties. To properly maintain segregation of duties, separate employees should handle receiving the money, posting to the general ledger, depositing the money to the bank, and reconciling the accounting records and bank statement. Based on our interviews and observations, it appears Employee A handled almost all these duties, which presented the opportunity to make deposits of Commission revenues into the Foundation's bank account. According to Commission staff, an employee other than Employee A opened the mail, filed the assessment reports submitted with the payments, and recorded the payments into a database, which was not used to support the general ledger. The checks were given to Employee A, who completed the deposit slips,

deposited the money at the bank, and subsequently accounted for the payments in the general ledger. We noted the amount deposited to the Commission's bank account was the amount recorded in the general ledger, but was not verified to the total amount of checks received. Therefore, Employee A did not fully account for all the revenues received, thereby understating the Commission's revenue in the general ledger. As a result, the Commission's general ledger may not be a reliable representation of the Commission's operations.

Lack of Support for a Journal Entry

To further complicate the reliability of the general ledger, we noted an adjusting journal entry for \$41,332 described as a "reconciliation discrepancy" that appears to be a forced amount to balance the general ledger. Based on our discussion with the contracted Bookkeeper, the journal entry was based upon the general ledger's software recommendation after the Bookkeeper traced the deposits and checks in the general ledger to the bank statement. The Bookkeeper indicated the variance might have been a result of Employee A batching the revenues and expenses together, which left no detail of the composition in the general ledger. The Bookkeeper did not thoroughly analyze whether the batched amounts consisted of legitimate transactions prior to making the adjusting journal entry. For instance, the Bookkeeper did not determine whether all checks posted to the general ledger cleared the bank because, as previously mentioned, there was no detail, such as individual check numbers and amounts, of the batched expense available. We understand the Bookkeeper needed a starting point since Employee A did not maintain detailed accounting records. However, we caution making adjusting journal entries without thoroughly analyzing variances because legitimate transactions may have been inadvertently eliminated. We recommend properly documenting the journal entry to clearly show the reason for the adjustment to provide a clear audit trail.

Lack of Review over Assessment Reports

A review of the assessment reports revealed a possible loss of revenues due to miscalculations on the assessment reports. It does not appear the Commission staff reviewed the calculations of the report or compared it to the payment to ensure the payee accurately calculated the amount due. As a result, several assessment payers paid less than the required tonnage fee. We noted instances when the assessment payer reported an amount, but did not accurately calculate the fee. For instance, we noted one assessment payer reported 1,060.01 tons and paid \$1,060.01 rather than \$10,600.10 at \$10/ton resulting in a loss of \$9,540.09.

Supporting Documentation for Expenses

Although our audit was limited in scope and we did not completely review all Commission expenses, we reviewed checks paid to Employee A for reimbursable expenses. We noted that the Commission reimbursed Employee A for meals totaling \$4,051, which Employee A paid for with a personal credit card. Employee A provided the credit card slip or a hotel bill listing the restaurant name and amount billed to the room, as supporting documentation. These meal expenses were not supported with itemized receipts. Even though the purpose and recipients of the meal were noted the majority of the time, having an itemized restaurant receipt provides transparency to the nature and reasonableness of the expense. Furthermore,

Employee A was reimbursed \$82 for in-room movies charged to the hotel room, which we deem as personal expense since it does not further the Commission's purpose.

Agreement with the Foundation

As noted above, the relationship between the Commission and Foundation is based on an agreement. This agreement states that the Commission will provide management and administrative services on behalf of the Foundation for \$1 annually, effective April 1, 2007. According to Commission staff, this agreement was signed after Employee A left the Commission. Therefore, this relationship existed prior to both parties having formalized the agreement. Due to our limited audit scope, we only reviewed the agreement between the Commission and the Foundation. The Commission should be cautioned that conducting business without a formalized agreement exposes the Commission to a loss. Additionally, the Commission should review its agreement to take into consideration the costs associated with providing management and administrative services, since the Foundation is paying \$1 annually for Commission services.

Recommendations (continued)

- 2. The Commission should perform a comprehensive review of all current internal controls over revenue to improve its accountability and to ensure there is proper segregation of duties. This review should document the current controls in place that are intended to safeguard the revenue.*
- 3. Adjustments to the general ledger should not be made unless they are thoroughly analyzed and properly documented to ensure the general ledger properly reflects the entity's operations.*
- 4. The Commission should review and compare the assessment reports to the payee checks to ensure the assessment payer correctly paid the mandatory assessment fees.*
- 5. The Commission should require an itemized receipt as support for all reimbursement of charges on the employee's personal credit card, including business meals.*
- 6. The Commission should only incur expenses necessary to support the Commission's mission. Reimbursements should be reviewed and scrutinized prior to payment. Only expenses that are for a legitimate Commission purpose should be reimbursed.*
- 7. The Commission should ensure all contractual relationships are formalized prior to the execution of the agreement. This will protect the Commission if a dispute were to arise.*
- 8. The Commission should revisit the agreement with the Foundation to ensure all costs associated with the Foundation are recovered. We urge the Commission to adopt a full cost recovery policy that includes overhead costs when contracting to provide any services to the Foundation.*

MENDOCINO WINEGRAPE AND WINE COMMISSION'S RESPONSE

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August 1, 2008

Dear Mr. Shackelford,

Enclosed is the Mendocino Winegrape and Wine Commission's response to the preliminary draft audit recommendations completed by the California Department of Food and Agriculture audit team.

Please contact me, or the Commission's legal counsel, Jill England, if you have any questions after reviewing our response.

Sincerely,

Rich Schaefer
Chairman
Mendocino Winegrape & Wine Commission

cc: Linda Berg Gandara (via email)
Jill England (via email)

Response to Preliminary CDFA Audit Report Key Recommendations

1. *Due to the seriousness of the issues raised, the Commission should contact the proper authorities so that investigations into these issues may be performed.* The Mendocino Winegrape and Wine Commission ("Commission") has recovered all amounts shown by the audit to have been misappropriated by Employee A. The Commission has also recovered the cost of the audit, attorney's fees, bookkeeper fees, estimated interest on the misappropriated funds, and additional miscellaneous amounts from Employee A.
2. *The Commission should perform a comprehensive review of all current internal controls over revenue to improve its accountability and to ensure there is proper segregation of duties. This review should document the current controls in place that are intended to safeguard the revenue.* Since the first sign of misappropriation, the Commission has taken necessary action to enable clear and concise internal and external controls over Commission funds. The Commission has hired a bookkeeper who has since analyzed the Commission QuickBooks and reconciled funds. For Commission staff, one employee opens the mail, and another employee copies all checks, records them in the deposit book and codes them to the correct budget line item. The President reviews the documentation and after review the Office Manager takes the deposit to the bank and returns a receipted copy of the deposit slip to the President and Bookkeeper who matches it up with the check copies. All deposit documents are then handed over to the bookkeeper for complete reconciliation of the Commission account. These and other procedures are detailed in the attached "Financial Control Procedures" protocol now in effect for all Commission business. The MWF board of directors has also taken the necessary precautions with their bank account. They have ordered new checks and have made sure that all checks are dual signature as to eliminate the lack of control of just one signer.
3. *Adjustments to the general ledger should not be made unless they are thoroughly analyzed and properly documented to ensure the general ledger properly reflects the entity's operations.* The adjustment to the ledger was what our bookkeeper and Finance Committee Chairman thought would be the best and only way understand and reconcile the transactions of 2006 which Employee A had corrupted in QuickBooks. They did perform as much analysis as the incomplete paper records and corrupted computer files would allow. This is the work that initially revealed the nature of the fraud that was perpetrated. The Commission bookkeeper and Financial Chairman completely understand that this is never to be done again
4. *The Commission should review and compare the assessment reports to the payee checks to ensure the assessment payer correctly paid the mandatory assessment fees.* The Commission understands that there were some incorrect assessment reports and has taken the necessary action to retrieve the correct monies. In the meantime, the Commission has hired the California Grain and Feed Association ("CGFA") to handle all Commission assessment collections. The Commission feels as though this organization is better suited and more knowledgeable in collections and are confident that these miscalculations will be routinely detected under their controls. The Commission will work with the CGFA to make sure that there are itemized tracking of all assessment reimbursements and that individual producers/vintners do not automatically convert their reimbursement into their initial tonnage assessment

payment. If they do, the CGFA will ask that the producer/vintner issue the correct amount for the tonnage fee and then submit a letter for reimbursement as per the Commission Assessment Collection Procedures.

5. *The Commission should require an itemized receipt as support for all reimbursement of charges on the employee's personal credit card, including business meals.* The Commission has started itemizing all employee expenses. Each expense has to be directly linked to an approved budget line item. All reimbursement requests must include an itemized receipt, including meal expenses. The Finance Chair and Office Manager will then review all expenses and deem them appropriate Commission expenses prior to issuing a reimbursement check. These and other procedures are detailed in the attached "Financial Control Procedures" protocol now in effect for all Commission business.
6. *The Commission should only incur expenses necessary to support the Commission's mission. Reimbursements should be reviewed and scrutinized prior to payment. Only expenses that are for legitimate Commission purpose should be reimbursed.* The Commission has tightened up procedures to avoid future occurrences of expenses that are not legitimate. These and other procedures are detailed in the attached "Financial Control Procedures" protocol now in effect for all Commission business.
7. *The Commission should ensure all contractual relationships are formalized prior to the execution of the agreement. This will protect the Commission if a dispute were to arise.* The Commission now has a signed contract between the MWF and MWWC. Employee A was responsible for obtaining these signatures at the beginning of his tenure but he did not follow through. Since Employee A's dismissal, Commission staff has made sure that all contracts are signed and that legal counsel has a signed copy for their records as well.
8. *The Commission should revisit the agreement with the Foundation to ensure all costs associated with the Foundation are recovered. We urge the Commission to adopt a full cost recovery policy that includes overhead cost when contracting to provide any services to the Foundation.* The Commission is revisiting their agreement with the MWF. The Commission and MWF's Executive Committees will be meeting to discuss the future of their agreement. It was recommended that these two organizations dissolve their staffing and fiscal management relationship but no action has been taken on this matter until both organizations understand the implications of this decision and agree on them. Should it be decided to continue the relationship, it will only be with the contractual requirement of full cost recovery.

C DFA EVALUATION OF RESPONSE

A draft copy of this report was forwarded to the Mendocino Winegrape and Wine Commission, for its review and response. We reviewed the response and it addresses the findings in this report.

DISPOSITION OF AUDIT RESULTS

The findings in this report are based on fieldwork my staff performed May 5, 2008 through May 16, 2008. My staff met with management on May 16, 2008 to discuss the findings and recommendations, as well as other issues.

This report is intended for the CDFA and the Commission for their review and action if necessary. However, this report is public document and its distribution is not restricted.

REPORT DISTRIBUTION

<u>Number</u>	<u>Recipient</u>
1	Chairman, Mendocino Winegrape and Wine Commission
1	Legal Counsel, Mendocino Winegrape and Wine Commission
1	Director, CDFA Marketing Services Division
1	Branch Chief, CDFA Marketing Branch
1	Chief Counsel, CDFA Legal Office
2	Chief, Audit Office